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IN THE

Supreme Court of the United States

October Term 1952

JACOB LICHTER AND JENNIE L. LICHTER,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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PRAYER

Petitioners pray that a writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Sixth Circuit, entered in the above entitled case on December 19th, 1952.

OPINIONS BELOW

The decision of the Tax Court of the United States, including its Findings of Fact and its Opinion, was rendered on the 7th day of January, 1952, is contained in the Record herein at page 97, and is reported in 17 T.C. 1111.

The Opinion of the United States Court of Appeals was rendered on the 19th day of December 1952, and is unreported. A copy thereof is set forth in the Appendix hereto at page 7a.

JURISDICTION

Jurisdiction of this Court with respect to the within matter and petition is had by virtue of the Sections 1254 and 2101 of the Judicial Code as contained in Title 28 of the *United States Code*, and as set forth in 28 *United States Code Annotated* Sections 1254 and 2101.

QUESTIONS PRESENTED

Whether payments made by Southern Fireproofing Company (a partnership composed of petitioners), to the Central Trust Company, Trustee of Petitioners' Bonus and Profit Sharing Plan, are deductible by Petitioners for income tax purposes for the calendar years 1942 and 1943, under and by virtue of the provisions of Sections 165 and 23(p)(1)(A) and (D) of the *Internal Revenue Code.*

STATUTES INVOLVED

The following statutes are involved herein:

Section 23(p)(1)(A) and (D) of the Internal Revenue Code which is set forth in the Appendix hereto at page 2a.

Section 165 of the Internal Revenue Code which is set forth in the Appendix hereto at page 1a.

Treasury Regulations 111 are also involved. Sec. 29.23(p)-1 and Section 29.23(p)-11 thereof are likewise set forth in the Appendix hereto at page 3a.

STATEMENT OF CASE

Petitioners, Jacob Lichter and Jennie L. Lichter, are husband and wife, and partners of the Southern Fireproofing Company, masonry contractors, with offices at 907 Federal Reserve Bank Building, Cincinnati, Ohio.

In 1941, Petitioners, as such partners, inaugurated a Bonus and Profit Sharing Plan for certain of its employees. In the calendar years 1942 and 1943, Petitioners, as such partners, made payments for specifically named employees to The Central Trust Co., of Cincinnati, Ohio, the duly authorized and appointed Trustee of the Bonus and Profit Sharing Plan.*

Respondent disallowed the deductions taken by Petitioners on the firm's income tax return for the aforementioned payments, and increased Petitioners' net income to that extent. In the Tax Court and the U. S. Court of Appeals, Respondent's action in this respect was affirmed. The U. S. Court of Appeals opinion is made a part of this Petition by attachment in the Appendix (Page 7a hereof).

The issues in the Tax Court and in the U. S. Court of Appeals were:

(a) Whether the payments into the Bonus and Profit Sharing trust in 1942 were for the exclusive benefit of the employee-beneficiaries within the meaning of Section 165 (a)(2) of the Internal Revenue Code and accordingly deductible under 23(p)(1)(A) and

(b) Whether the payments in 1942 and 1943 were deductible under Section 23(p)(1)(D) of said Code for the reason that the employees' rights with respect thereto were "nonforfeitable" without regard to whether the Plan complied with Section 165(a)(2) of the Code.

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* Note: In the Tax Court the validity of the partnership was assailed by Respondent, but the Tax Court reversed Respondent on this issue. It was not an issue in the Court of Appeals.

Petitioners argued in the Tax Court and in the U. S. Court of Appeals, that the trust was for the exclusive benefit of their employees and that the payments in 1942 were properly deductible under 23(p)(1)(A) of the Internal Revenue Code, and that with reference to 1942 and 1943 payments, an enforceable beneficial interest was granted to the employees at the time the payments were made, viz., the employees' rights were "nonforfeitable," and thus payments for both of said years were deductible under 23(p)(1)(D). In this respect Petitioners demonstrated:

(1) That the preamble portions and the whereases of the agreement state that it is for the exclusive benefit of the employees (R. p. 61).

(2) That the duties, acts and authority of the Advisory Board are limited, and in no instance may the Advisory Board divest the employees of the interest assigned to them in the trust (R. p. 61-62).

(3) That upon the payments being made by the Trustee, either bonds or insurance were purchased for the specifically named employees, and separate accounts set up for such employees on the books of the Trustees (R. p. 52).

(4) That in many instances, the named employees have withdrawn the bonds or insurance assigned to them, or both (R. p. 54-57); that the actions of the parties in their interpretation of the agreement, should not be ignored.

(5) That, finally, Article IX of the Trust Agreement states as follows (R. p. 64):

"Notwithstanding anything in this agreement to the contrary under no circumstances shall any policy or the proceeds thereof, or any other property or assets of this trust, revert to the employer, nor shall the employer be entitled to exercise any rights or options in regard to said policies, property or assets, or derive any benefits therefrom."

and thus, the res of the trust was not only for the exclusive benefit of employees, but also the interest of employees in the res was nonforfeitable.

On the 26th day of January, 1948 (*Note*: the Tax Court proceedings were docketed August 1, 1949), the Administrator of a deceased employee brought suit against The Central Trust Company, Trustee, the Advisory Board and Petitioners, in the Common Pleas Court, Hamilton County, Ohio; this suit was entitled *C. W. Steinkamp, Administrator of the Estate of H. L. Pullen, deceased, and Mary Louise Pullen, sole heir and beneficiary under the will of H. L. Pullen* v. *Central Trust Company, O. H. Utz, Secretary, Advisory Board, Bonus and Profit Sharing Plan, Southern Fireproofing Company and Jacob and Jennie L. Lichter*, being numbered A-108490 in the records of said court.

The prayer of this suit sought to compel The Central Trust Co., as such Trustee, to deliver the bonds held for Herbert L. Pullen, a deceased employee, to his estate.

Petitioners resisted the employee's action for the reason that if the Common Pleas Court case ordered delivery of the bonds, *and* if Respondent were not overruled in his disallowance of the deductions involved herein, Petitioners would have made payments to employees under said plan and would not receive deductions therefor on their income tax returns.

The Trial Court in said suit ordered that the bonds should be delivered to the Administrator of Herbert L. Pullen, deceased, the former employee, and upon a finding that *the property of the trust could in no event revert to Petitioners.*

Petitioners appealed and the Ohio Court of Appeals in a trial de novo likewise ruled in favor of the Administrator of the deceased employee, and ordered the bonds to be delivered to the employee's Administrator, for the reason that the employee had a valid, enforceable interest in the

property of the trust in his name and that the property of the trust may not revert to Petitioners. The Ohio Court of Appeals order is made a part of this Petition by attachment in the Appendix (Page 9a hereof). The Ohio Court of Appeals opinion and order were both entered *subsequent* to the opinion and order of the U. S. Court of Appeals below.

Petitioners have filed a petition for certiorari to the Supreme Court of Ohio which is presently pending. Should the Ohio Supreme Court grant certiorari and reverse the Ohio Court of Appeals, Petitioners would have no further desire to prosecute this petition. This petition is filed now, rather than after final determination by the Ohio Supreme Court, as there is a likelihood that no determination will be had by the Ohio Supreme Court within the 90 day period following the U. S. Court of Appeals order, within which time Petitioners must file this petition.

Throughout this petition it will be assumed that the Ohio Court of Appeals is affirmed by the Ohio Supreme Court. In case of a reversal, this petition will be dismissed. Petitioners will file a supplementary information to this Court at the time of a determination by the Ohio Supreme Court.

We respectfully suggest that this Court might properly withhold its decision upon this petition pending such determination by the Ohio Supreme Court.

REASONS FOR GRANTING WRIT

and

ARGUMENT IN SUPPORT THEREOF

The reason for granting this Writ is that the U. S. Court of Appeals below has rendered a decision in direct conflict with applicable local decisions on an important question of local law.

The conflict is simple and clear:

The Ohio Court of Appeals has interpreted the Ohio trust in question as creating nonforfeitable interests in its employee beneficiaries; a state of the law which *should* amply satisfy the requirements of Sec. 23 (p)(1)(D) of the Revenue Code as to tax deductibility.

Nevertheless a U. S. Court of Appeals in a decision made, unfortunately, *prior* to the Ohio decision, and without benefit of this Ohio holding as to the particular trust in question, has held that payments into this trust are *not* nonforfeitable and has therefore denied to Petitioners the right to deduct them for income tax purposes.

This direct conflict between a U. S. Court of Appeals and a State Court of Appeals is one which, if not remedied, will result in unfair injury to Petitioners' rights. We submit that it is not consistent with the philosophy of the American court system for this sort of judicial schizophrenia to remain unremedied, and that to afford such a remedy is an apt and urgent reason why this Court should grant certiorari here.

The question decided by the U. S. Court of Appeals was basically one of Ohio law, namely, whether the particular trust in question, by its terms, rendered the rights of its employee beneficiaries in the trust res nonforfeitable at the time of a payment into such a trust.

However, see *Forsyth* v. *Hammon*, 17 Sup. Ct. 665, 166 U. S. 506, to the effect that this Court should exercise its jurisdiction to resolve a conflict between a state and a federal court even though the question is not one of local law.

Petitioners, to use the vernacular, have been caught "coming and going." The U. S. Court of Appeals has said that they may not deduct payments into the trust in question as the trust res is not nonforfeitable to their employees. The Ohio Court of Appeals has said that they may not recover back trust assets since the trust res is specifically nonforfeitable.

We urge that to resolve such a dilemma is a situation uniquely fitted to the exercise of this Court's jurisdiction.

While it is recognized that deductions from gross income are matters of legislative grace, as has been said by this Court on several occasions, it is nevertheless proper to point out that when business expenses are made in good faith, they should be deductible unless the reasons for not permitting them are quite clear, especially in an instance like this, when the matter involves payments to employees in payment for meritorious services. Petitioners quite properly feel aggrieved when, on the one hand, the State Court says to Petitioners' Trustee "hand over the bonds to the employees" and to Petitioners "you have no right to the bonds, it's a valid and enforceable trust"; and when, on the other hand, the United States Court of Appeals says that the interests of the employees are not nonforfeitable, and therefore the payments are not deductible.

It should be pointed out also that the U. S. Court of Appeals is in error in its consideration of the matter. While we realize that mere error is not usually enough to justify the exercise of the Court's jurisdiction to grant a petition for certiorari, the Court might indeed hesitate to exercise its discretion for other reasons if it felt that the Court of Appeals was correct in its consideration of the issues. We therefore feel it proper to briefly state the reasons why the Court of Appeals is in error.

Section 165 Internal Revenue Code, as it existed and as it was applicable for the calendar year 1942 (1938 Act) is as follows:

> Sec. 165. EMPLOYEES' TRUSTS.
>
> (a) Exemption from Tax.—A trust forming part of a stock bonus, pension, or profit sharing plan of an employer for the exclusive benefit of some or all of his employees

1) If contributions are made to the trust by such employer, or employees, or both, for the purpose of distributing to such employees the earnings and principal of the fund accumulated by the trust in accordance with such plan, and

2) If under the trust instrument it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of his employees, shall not be taxable under Section 161. . . .

Section 23(p)(1)(A) and (D) Internal Revenue Code, as it was applicable for both the calendar years here involved—1942 and 1943—is as follows:

Sec. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions: * * * * * *

(p) Contributions of an Employer to an Employees' Trust or Annuity Plan and Compensation under a Deferred-Payment Plan.

(1) General rule.—If contributions are paid by an employer to or under a stock bonus, pension, profit-sharing, or annuity plan, or if compensation is paid or accrued on account of any employee under a plan deferring the receipt of such compensation, such contributions or compensation shall not be deductible under subsection (a) but shall be deductible, if deductible under subsection (a) without regard to this subsection, under this subsection but only to the following extent:

(A) In the taxable year when paid, if the contributions are paid into a pension trust, and if such taxable year ends within or with a taxable year of the trust for which the trust is exempt under section 165(a), in an amount determined as follows:

* * * * * *

(D) In the taxable year when paid, if the plan is not one included in paragraphs (A), (B) or (C), if the

> employees' rights to or derived from such employer's contribution or such compensation are nonforfeitable at the time the contribution or compensation is paid.

With respect to the payments made to the Trustee of Petitioners' Bonus and Profit Sharing Plan in 1942 the Tax Court held (R. p. 110):

(a) That the Plan did not comply with Section 165 and therefore that 23(p)(1)(A) did not apply; and

(b) That 23(p)(1)(D) did not apply because the employees' rights to the payments made into trust were not nonforfeitable at the time the payments were made.

Section 165 (supra p. 8) says only (a) that the contribution must be for the purpose of distributing a fund to the employees in accordance with a plan and (b) that no part of the fund can be directed to a purpose other than the benefit of the employees.

Both of these standards are met.

As to (a) there is no comment by the court: the Plan (Exhibit 26; R. p. 61) is for the purpose of distributing a fund to employees in accordance with its provisions.

As to (b) the Trust Agreement itself is clear that the fund cannot be directed to a purpose other than for the benefit of the designated employees of the Southern Fireproofing Company.

The "Whereases" of the Plan (Exhibit 26; R. p. 61) are:

> WHEREAS, the Employer desires to reward and compensate certain of its employees for their faithful and beneficial services rendered the Employer, in such a manner as will establish protection and security to the employees and their respective families, and dependents, and
>
> WHEREAS, the Employer desires to deposit with the Trustee such sums of money or property for the benefit of such employees and their respective families and dependents with the specific intent of carrying out its said purposes;

Article IX of the Plan is:

> Notwithstanding anything in this agreement to the contrary, under no circumstances shall any policy or the proceeds thereof, or any other property or assets of the trust revert to the Employer, nor shall the Employer be entitled to exercise any rights or options in regard to said policies, property or assets, or derive any benefits therefrom.

We submit that under the terms of the trust, neither the Trustee nor the Advisory Board may perform any act inconsistent with the foregoing language. *Only* Petitioners' employees may benefit.

And quite apart from the statements in the Trust Agreement itself as to the employees' sole interest, the evidence shows (this brief p. 4; R. p. 52), not only that the Trustee set up ownership accounts on its books for employee-beneficiaries, but that many of the employees have been paid in accordance with the directions of the Advisory Board at the time the contributions were made by Petitioners.

The factors relied upon by the Tax Court (R. p. 97-110) and the U. S. Court of Appeals, indicating that the plan was not for the exclusive benefit of the employees are: that the powers of the Trustee are limited; that the Advisory Board is appointed by the employer; that the employer has the right to amend; and that there are no standards for individual sharing.

None of these factors prevent the Plan from complying with the applicable legislation for the calendar year 1942. These factors do not prevent the trust from being for the exclusive benefit of the employees as a group. This is indisputably shown by two things: (a) the employer may not get back any part of the trust nor may it be diverted to anyone other than employees; (b) the trust is created for the benefit of "employees" directly, or indirectly by providing security for their families. Thus the requirement of the statute is met.

The U. S. Court of Appeals may have been confused by the emphasis placed on the individual employee's right to what had been placed to his name. The Court should keep in mind that it is the "employees' " interest, *as a group*, which the statute looks at.

This is not a factor which permits the court to strike down the Plan, because it does not show that the Plan was not for the exclusive benefit of the employees as a group nor do they show that the interests of the group of employees are not nonforfeitable.

Admittedly the Plan does not comply with the standards of the applicable legislation for the calendar year 1943, *but it makes no difference whether Plan does or does not comply* because Section 23(p)(1)(D) permits the deduction *nevertheless* if the employees' interests are nonforfeitable. The interests of the employees are nonforfeitable, as we have shown above, and as the Ohio Court of Appeals has held.

The Court can fairly ask then, wherein is the difference if payments are deductible whether the trust be a complying one or a non-complying one. The difference is in the treatment of the employees' interest, which is not here involved. Under the qualified trust the employees' interest is not taxed until it is made available to them; under a non-qualified trust the employees' interest is taxable to them when it becomes nonforfeitable. (The Tax Court excluded proffered evidence of Petitioners that the employees for whose benefit contributions were made in 1942-43 had been taxed on such contributions.)

In summary, then, the trust agreement itself, as well as the course of action taken by all the parties thereunder, shows that it was Petitioners' intent to have a bonus and profit sharing plan for the exclusive benefit of the employees and that the interests of the employees were to be considered to be nonforfeitable.

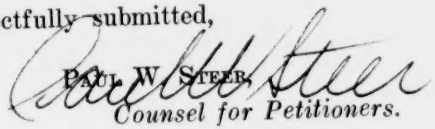
Accordingly, the U. S. Court of Appeals was in error in its consideration of the matter.

In any event, Petitioners are caught in-between the conflict in rulings between the State Court and the Federal Court, and relief should be afforded. Petitioners, in fairness and in equity, should either be entitled to funds deposited or the deduction—one or the other.

CONCLUSION

For the reasons aforementioned, Petitioners respectfully pray that a Writ of Certiorari issue to the judgment of the United States Court of Appeals for the Sixth Circuit, entered in the above entitled case on December 19, 1952.

Respectfully submitted,



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